The Effect of Accounting Choices on the Ability to Raise Debt

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This study uses a choice allowed under IFRS - whether to account a business combination under a common control (BCUCC) using target book values or using fair values generated from a purchase price allocation - to provide evidence on the effect fair value accounting choices may have on firms' ability to issue more debt. A business combination under common control is a merger of two entities owned by the same parent company. This transaction does not change the fundamentals of the parent company but can change its financial reports if the parent company chooses to record the merger using fair value. We find that consistent with the favorable balance sheet effect of using fair value to record BCUCC: a parent company is likely to choose fair value to record BCUCC when its' leverage is high and when it has a net worth covenant on its debt. Using propensity-score to match firms that used fair value to account for a BCUCC with a control group of firms that did not conduct a BCUCC, we find that firms that made fair value to record BCUCC when its' leverage is high and when it has a net worth covenant on its debt. Using propensity-score to match firms that used fair value to account for a BCUCC with a control group of firms that did not conduct a BCUCC, we find that firms that made fair value BCUCC are more likely to issue new public debt following the BCUCC.